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STATE FOR WHA/AND
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E.O. 12958: N/A
TAGS: ECON EINV ENRG EPET PREL BL
SUBJECT: PETROBRAS PUSHES BACK

REF: A. A) LA PAZ 251

¶B. B) LA PAZ 890
¶C. C) LA PAZ 869

¶1. (SBU) Summary: Despite industry fears that Brazilian-owned Petrobras, a leader in Bolivia's hydrocarbons industry, would work out a sweetheart deal with the GOB, the relationships between Bolivia and both Brazil and Petrobas have gone steadily downhill during the past month. Petrobras has not signed a memorandum of understanding with the GOB as planned (ref A), and will determine its next steps based on the nationalization decree that the GOB has pledged to announce in mid-April. Bolivia and Brazil will hold gas price negotiations in mid-April, as required by the existing contract. According to a Petrobras contact, Bolivia will likely be disappointed in the outcome, due to its unrealistic ideas of gas reference prices. Petrobras and U.S. firm Vintage both expressed to us in recent meetings that they are not "service companies" and do not intend to migrate to "service contracts", but will fight back if the GOB insists on this model. Both companies relayed their concern about Venezuelan and PDVSA influence on the GOB and its drafting of the nationalization decree and model contracts. End summary.

The GOB-Hydrocarbons Company Honeymoon is Over
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¶2. (SBU) In an April 4 meeting, Dr. Arturo Castanos, Petrobras' Director of Institutional Relations, explained to Econoffs that the relationship between the GOB and the Brazilian hydrocarbons giant Petrobras (Bolivia's largest operator) had taken a turn for the worse since the beginning of March. At the end of January, the new MAS administration held courtesy calls with Petrobras executives and agreed to sign a memorandum of understanding (MOU), outlining a negotiation strategy (ref A). Most industry representatives expected that Petrobras and the GOB would work out a deal to the detriment of other industry players. Petrobras sent a draft MOU to the GOB in February, but received no response.

According to Castanos, the GOB expressed interest during February in gaining control of Petrobras' refineries, but "did not want to pay anything" for them. Thus, no MOU was signed and contact between the GOB and Petrobras ended in late February.

¶3. (SBU) During March, the GOB became more aggressive in its behavior towards both Brazil and Petrobras, with Hydrocarbons Minister Soliz Rada railing against "Brazilian imperialism" in the press and badly treating a Brazilian state governor from Matto Grosso do Sul in a recent meeting. Castanos claimed that the GOB had begun looking for points on which to attack Petrobras, as it had already done with Repsol (the Spanish/Argentine hydrocarbons company that is the second largest operator in Bolivia) (ref B). Petrobras has responded to the GOB's antagonistic tone by issuing press statements threatening to further freeze investments due to the GOB's unilateral interruption of negotiations and lack of communication. (Note: Although Petrobras may freeze additional investments, the sum is not as significant as recent press articles have stated. Castanos explained in an earlier meeting that Petrobras never intended to invest USD 5 billion in Bolivia as the press previously quoted. He said that the largest project under consideration is a USD 1.3 billion petrochemical project that would be financed by Braskem, Repsol, Petrobras, and others. End note.) In a further expression of discontent, which Castanos described as a deliberate slight encouraged by Petrobras, Brazilian President Lula refused to meet with Bolivian President Evo Morales during the April 3rd Inter-american Development Bank meeting in Belo Horizonte, Brazil.

Petrobras' Next Steps

¶4. (SBU) The next steps for Petrobras are unclear, but depend on the terms of the nationalization decree that the GOB has pledged to emit in mid-April (ref C). Vice President Garcia Linera stated on television that nationalization would consist of seven "pillars": recouping state control over hydrocarbons at the wellhead, state control over distribution and commercialization, gaining majority shareholder status in the capitalized companies, promoting natural gas industrialization, distributing natural gas to the population, sanctioning companies that do not comply with the rules, and guaranteeing legal security to foreign investors.

¶5. (SBU) Castanos stated that the control over commercialization and the GOB's intention of relegating the hydrocarbons companies to "service providers" are the most objectionable parts of the plan. He stated unequivocally that Petrobras is not interested in being a service provider, which would mean having to take whatever price the GOB was willing to pay for its services. He added that Petrobras, backed by Brazil, would consider one of the following options if the GOB insisted on its "seven-pillar plan": 1) Petrobras and/or Brazil would do nothing for political reasons (the most unlikely option); 2) Brazil would stop buying Bolivian gas -- this is a double-edged sword because Brazil relies on Bolivian gas for four percent of its energy needs, and Bolivia relies on Brazil for its market without which Bolivia would not be able to produce enough gas from which to extract the liquids that it uses domestically; 3) Brazil would continue to import Bolivian gas but not pay for it, perhaps setting up an indemnity fund to compensate Petrobras for its investment losses; or 4) Petrobras would negotiate with the GOB for the next three years's gas supply, giving Brazil enough time to find substitutes for Bolivian gas.

Bolivia's Pipe Dreams About Gas Prices

¶6. (SBU) Castanos told us that Brazil and Bolivia will hold gas price negotiations in mid-April, as required by the existing contract between the two nations. He claimed that the price paid by Brazil for Bolivian gas could only be increased if the Brazilian government were willing to subsidize gas for domestic consumers, who would not tolerate a significant price increase. Brazil, however, was in the

process of decreasing energy subsidies and was unlikely to implement new ones, Castanos said. Election year politics in Brazil, he argued, would not support any financial concessions to the Bolivians. He lamented that Bolivian Hydrocarbons Minister Soliz Rada did not understand that gas was not a commodity and that higher U.S. and Chilean gas prices could not be used as references for Bolivian gas. He added that Bolivia has not submitted a proposal on price changes to Brazil, but has "negotiated" (as it has done in many other sectors) by issuing statements in the press.

Vintage Echoes Petrobras Complaints

¶7. (SBU) Jorge Martignoni, the President of Vintage Petroleum (owned by the U.S. company Occidental Petroleum), echoed Petrobras' concerns on April 4, telling the Ambassador and Econoffs that Vintage was not a service company, but an oil company. He noted that French-owned Total, one of the largest operators and reserve owners in Bolivia, had expressed the same sentiment to the GOB recently. He stated that Vintage, which is a relatively small player in Bolivia, is placing its hopes on Petrobras' ability to push back the GOB's unreasonable demands and establish a better investment climate for the sector. Martignoni stated that the GOB wanted to have more control over the private companies and was therefore planning to station YPFB (Bolivian state oil company) staff inside each company to monitor activities. Under the GOB's plan, YPFB would also have the authority to divvy up market share among the companies, deciding which companies would have the right to meet domestic and international demands. Vintage was particularly concerned by the GOB's plan, as recently explained to him by two Hydrocarbons Vice Ministers, to conduct audits of each company and charge each one differential tax rates depending on whether or not they had recouped their investments.

Still Waiting for Tax Breaks

¶8. (SBU) The GOB had previously promised Vintage to implement special tax incentives for producers with small fields as provided for in the May 2005 Hydrocarbons Law, but has not yet done so. After his meeting with the Vice Ministers, Martignoni became concerned that "special taxes" may mean the regular 50% rate set in the May law, while companies with "mega-fields" may be forced to pay taxes up to 60%. Martignoni complained that the GOB is creating conspiracy theories about the companies, claiming that they inflate their costs and do not pay enough taxes on their earnings. Martignoni said that if the GOB insisted on the companies signing "service contracts" and implemented the "seven pillars", Vintage, backed by U.S. giant Occidental Petroleum, would fight back. Occidental recently won an arbitration case in Ecuador, he explained, and would not balk at pursuing arbitration against Bolivia. If the situation deteriorated significantly, Vintage might pull out of the country, Martignoni said.

Venezuelan Woes

¶9. (SBU) Both Petrobras and Vintage executives expressed concern that PDVSA (Venezuelan state-owned oil company) staff are working at YPFB, and they have direct access to the presidential palace. Castanos claimed there are Venezuelans running things behind the scenes at the palace and that the nationalization decree is being drafted by them.

¶10. (SBU) Comment: During the first two months of the new administration, both the GOB and the hydrocarbons companies have behaved in a cordial fashion, exchanging statements about cooperation and "nationalization" without expropriation. However, the wolves are beginning to shed their sheep's clothing as the conversations move from generalities to details. A clash could be on the horizon as both sides harden their lines. End comment.
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